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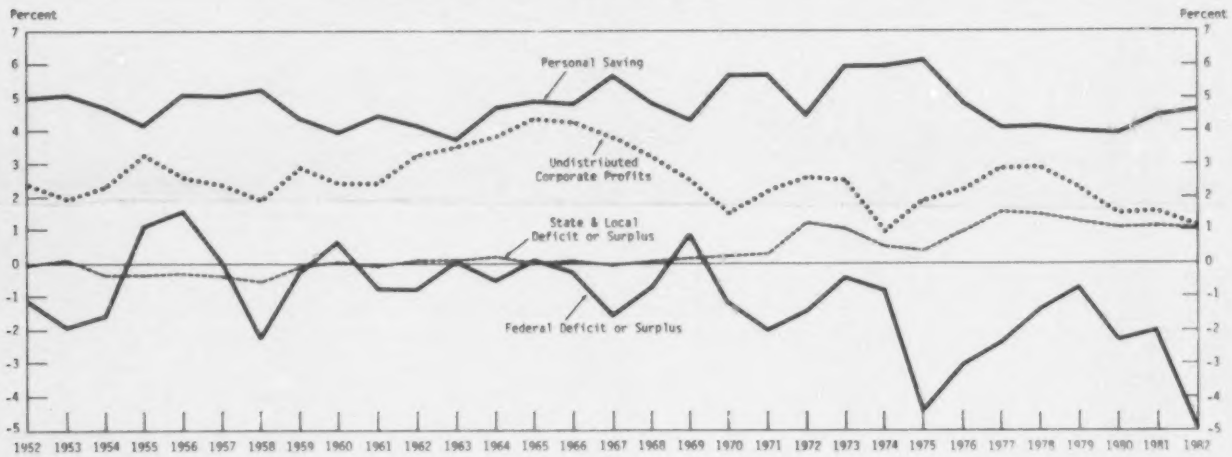
FinanceFacts

A Monthly Publication on Consumer Financial Behavior

JULY 1983

Saving by Sectors as Percent of GNP



American Financial Services Association Chart

Source: Department of Commerce

The economic recovery which began in December 1982 has now entered its eighth month. Although the recovery began somewhat sluggishly, the pace picked up in the spring and in many ways the upturn now resembles earlier post World War II recoveries at comparable stages. GNP, production, income, and employment all have jumped upward, and the rate of inflation has cooled (see pages 2 and 3). However, one important factor clouds what otherwise would be a favorable longer-term outlook: the prospect of huge Federal government budget deficits for the forseeable future.

Recessions and their aftermath always tend to increase Federal budget deficits. Recessions reduce Federal revenues because slower personal income growth coupled with declining corporate profits reduces the effectiveness of income taxes in raising revenues. At the same time, recessions raise Federal expenditures as unemployment compensation, food stamps, and other social programs to mitigate personal hardships swell spending totals. These aspects of economic policy, which tend automatically to increase the Federal budget deficit during recessions, are frequently referred to as "built-in fiscal stabilizers." Most observers believe such automatic changes in fiscal policy are useful in bringing the economy out of recessions.

The impact of recessions on Federal finance may be seen clearly in the chart. Although the Federal budget has been in deficit nearly every year in the past three decades, the largest deficits in relation to GNP have occurred during and immediately after recessions (1953-54, 1957-58, 1960-61, 1967, 1974-75, and 1980-82).

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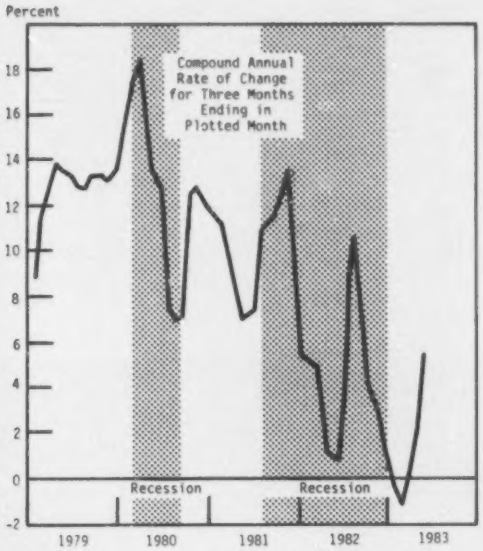
Change in Consumer Price Index

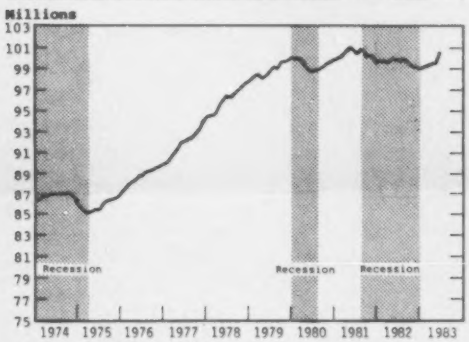
(All Urban Consumers, 1979-1983)



Source: Department of Labor

Total Civilian Employment

By Months (Seasonally Adjusted) 1974-1983



Source: Department of Labor

CONSUMER PRICES

The three-month compound annual rate of change in the Consumer Price Index for all urban consumers (CPI-U) took its largest jump of 1983 in May. The May increase measured 5.1%, compared with changes ranging between -1.2% (February) and +2.1% (April). This large recent jump probably in part prompted the Fed's July 14th announcement that it has been trying to control/slow money growth in order to keep inflation down as the recovery progresses. The unadjusted 12 month change figure of 3.5% since May 1982 reflects the progress made against inflation which this Fed action seeks to preserve.

CONSUMER INSTALLMENT CREDIT

Compared with an overall growth in consumer installment credit outstanding during 1982 of 4%, growth during 1983 has been much stronger. The seasonally adjusted 7% average first quarter figure was exceeded in April by an 8% annualized rate and in May by a 9.25% rate. The May figure represents $2.7 billion more outstanding than in April. The major contributor to the overall credit increase was the automobile category which increased almost twice as much as it had in April.

EMPLOYMENT

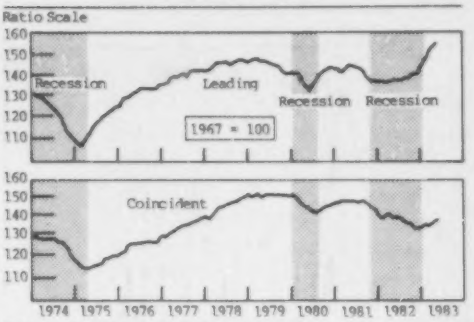
There was a significant increase in the number of persons employed in the U.S. in June, with the figure for civilian employment jumping a seasonally adjusted 1.2 million to a total of 100.8 million. At the same time, the number of civilian unemployed declined by 46,000 persons to just under 11.2 million. Proportionally, unemployment in both the total labor force (including resident armed forces) and in the civilian labor force declined, the associated figures being 9.8% and 10.0% respectively, down from 10.0% and 10.1% in May. The June figures show a continuation of the declining unemployment rates of 1983.

ECONOMIC INDICATORS

The composite index of leading economic indicators, designed to indicate the future direction of economic activity, was estimated by the Department of Commerce to have risen in May by 1.2%, bringing the index up to 154.5 (1967=100). The increases for March and April were revised to 2.0% and 1.4% respectively. The indicator contributing most to the May increase was net business formations, with all others except average workweek, change in sensitive materials prices, change in credit outstanding and vendor performance rising as well.

The index of coincident indicators, a measure of the level of current aggregate economic activity, rose also, by 1.1%, to a level of 137.3 (1967=100).

Composite Indexes By Month
1974-1983

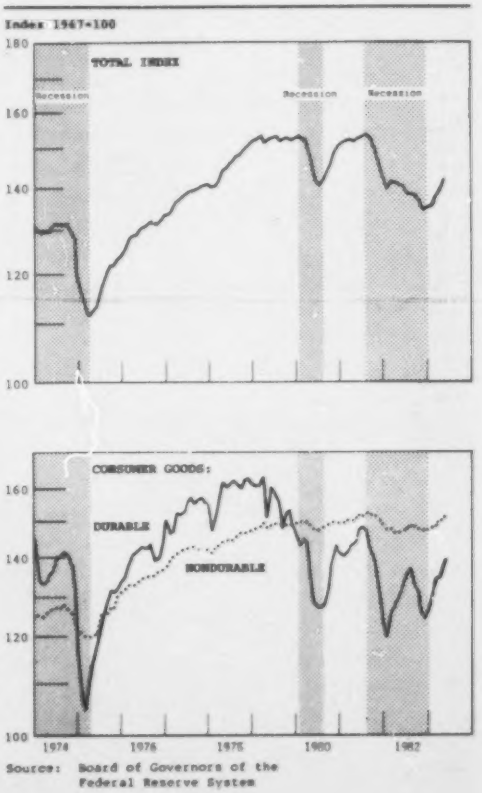


Source: Department of Commerce

PERSONAL INCOME

After a large increase of $30.1 billion (1.1%) in May, personal income in current dollars rose a moderate $13.4 billion (.5%) in June. Consumption expenditures, also in current dollars, increased 1.0% in June, after 1.8% and 1.6% increases in April and May. The fact that the increase in expenditures is greater than that in income may suggest a recovery mentality among consumers, which if continued should feed the recovery further. This tendency to spend is even more evident in constant dollar figures. While constant dollar disposable income rose by .1% and .5% in April and May respectively, spending, rose by .9% and 1.3%.

Index of
Industrial Production
by months (seasonally adjusted) 1974-1983



Source: Board of Governors of the Federal Reserve System

INDUSTRIAL PRODUCTION

The estimated change in industrial production for June matches the figure published for May, both increases being 1.1%. The largest component change contributing to the June increase was the 2.9% growth in production of durable goods, and the smallest was in nondurable goods, measuring .5%. Overall production is up 5.2% from a year ago, up 8.2% from the level at the trough of the recession last November, and about 5% below the high before the recession, which occurred in July 1981. The Federal Reserve characterizes the increase in production so far as "about typical for a postwar recovery."

Ysabel M. Burns

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However, after every recession trough before 1982 the magnitude of the Federal deficit quickly peaked and headed again toward balance. While balance has rarely been achieved (and not at all in the past dozen years), the changes in direction and magnitude are apparent in the chart. The only exception to this rule is the current situation in which deficits are projected to remain very large for many years.

The positive aspect of deficit spending is that it can help the economy emerge from recessions. The negative side, of course, is that the deficits must be financed either out of savings or by inflationary money creation. Because both the Administration and the Federal Reserve maintain that the latter is inappropriate, borrowing the public's savings becomes the only financing alternative.

The chart shows the components of savings by sector of the economy as a percent of GNP over the period 1952-82. Excluding the Federal government, total net savings consists of personal savings, undistributed corporate profits, and the surpluses of state and local governments. Adding these three components, total (non-Federal) net savings ranged from a low of 6.28 percent of GNP in 1960 (when the Federal budget was in surplus) to 9.41 percent of GNP in 1973. The problem is that the Federal deficit accounted for almost three quarters of (non-Federal) net savings in 1982 and will take almost as large a share in 1983. Such financing may be accomplished without too much economic disruption during recessions when corporate, home mortgage, and consumer borrowing demands are moderate, but clashes with private credit needs are likely if large deficits continue as the economy expands. So called "crowding out" of private borrowers could occur with continued mammoth deficits, even if private saving expands somewhat. Unfortunately, the impact of any crowding out would be on private capital formation. Higher real interest rates would lead to lower investment; and, ultimately, to lower growth in productivity and real incomes. Such an outcome would be very unfortunate and should be the chief concern of economic policy makers.

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